VIAVID
communications simplified.

Ciena Corporation

Fiscal Third Quarter 2021 Financial Results Conference Call

September 2, 2021

C O R P O R A T E P A R T I C I P A N T S

Gregg Lampf, *Vice President, Investor Relations*

Gary Smith, *President and Chief Executive Officer*

James Moylan, Jr., *Senior Vice President, Finance and Chief Financial Officer*

Scott McFeely, *Senior Vice President, Global Products and Services*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Tal Liani, *Bank of America Merrill Lynch*

Simon Leopold, *Raymond James*

George Notter, *Jefferies & Company*

Rod Hall, *Goldman Sachs*

Eric, *Morgan Stanley*

Paul Silverstein, *Cowen & Company*

Alex Henderson, *Needham & Company*

Samik Chatterjee, *JPMorgan*

Fahad Najam, *MKM Partners*

Jeffrey Kvaal, *Wolfe Research, LLC*

Amit Daryanani, *Evercore ISI*

Timothy Long, *Barclays*

James Suva, *Citigroup*

P R E S E N T A T I O N

Operator

Welcome to the Ciena Fiscal Q3 2021 Financial Results Conference Call.

At this time, all participants are in a listen-only mode. After the speakers' presentations, there will be a question-and-answer session.

I would now like to hand the conference over to your speaker today, Gregg Lampf. Thank you, please go ahead.

Gregg Lampf

Thank you, Stephanie. Good morning, and welcome to Ciena's 2021 Fiscal Third Quarter Results Conference Call.

On the call today is Gary Smith, President and CEO, and Jim Moylan, CFO. Scott McFeely, our Senior Vice President of Global Products and Services, is also with us for Q&A.

In addition to this call and the press release, we have posted to the Investor section of our website an accompanying Investor Presentation that reflects this discussion, as well as certain highlighted items from the quarter. Our comments today speak to our Fiscal third quarter performance, our view on market dynamics, as well as a discussion of our outlook for the fourth quarter.

Today's discussion includes certain adjusted or non-GAAP measures of Ciena's results of operations. A detailed reconciliation of these non-GAAP measures to our GAAP results is included in today's press release.

Before turning the call over to Gary, I'll remind you that during this call we'll be making certain forward-looking statements. Such statements, including our quarterly and annual financial guidance, discussion of market opportunities and strategy, and commentary about the impact of COVID-19 and supply constraints are based on current expectations, forecasts and assumptions regarding the Company and its markets, which include risks and uncertainties that could cause actual results to differ materially from the statements discussed today. These statements should be viewed in the context of the risk factors detailed in our most recent 10-K filing and in our upcoming 10-Q filing, which is required to be filed with the SEC by September 9. We expect to file by that date.

Ciena assumes no obligation to update the information discussed in this conference call, whether as a result of new information, future events or otherwise.

As always, we'll allow for as much Q&A as possible today, so we ask that you limit yourselves to one question and one follow-up, please. This call is being recorded and will be available for replay on the Investors page of our website shortly.

With that, I'll now turn the call over to Gary.

Gary Smith

Thanks, Gregg, and good morning, everyone.

The strong third quarter performance we reported this morning reflects a combination of our increasingly differentiated position in the marketplace and a robust demand environment. We delivered a record $988 million in revenue, and a particularly strong gross margin that drove a 19.1% adjusted operating margin, and a $0.92 adjusted earnings per share.

Overall, COVID-related challenges remain dynamic around the globe, but most of what we saw in the last several quarters is ameliorating. Importantly, the things we needed to happen in the market and for our business as we move through 2021 are materializing, largely as predicted. Specifically, industry and economic conditions have improved noticeably. Service provider spend globally continues to improve, and our customers' network investments and operations are normalizing.

We had strong order flow in Q3, and that outpaced revenue again. This allows us to continue growing our backlog and positions us to deliver the stronger than typical uptick in our second half performance that we expected.

Secular demand is very strong and we are taking full advantage of our leading position to address the opportunities that are driving network investment, including: capacity adds to address bandwidth demand; the shift to the cloud with new architectures and network builds; intense focus on edge applications; and obviously the need for network automation, as well as Huawei replacement opportunities.

Within this strong demand environment, however, there remain global and industry-wide supply chain constraints. As we've consistently proven, we have best-in-class ability to manage through this challenge and to deliver outcomes for our customers better than anyone else in our industry. However, as we've said before, we are not immune, particularly if supply challenges persist. As has been, I think, widely reported, conditions have somewhat deteriorated and are posing headwinds for Ciena, including difficulty to fully address demand. We have also seen some extension of our lead times and some increased costs. As we sit here today, we believe these challenges will likely persist through at least the middle of calendar '22.

Moving to highlights from the quarter, our competitive position remains strong and we continue to take market share. With respect to innovation, we are investing across three key sectors: optical, where we are the world leader in optical systems and its associated technologies, and we continue to drive our leadership in innovation and market share; routing and switching, where we are leveraging our optical expertise to offer a new architectural approach to disrupt the market with next-gen metro and edge use cases; and in software, where we are executing on and accelerating our automation strategy to digitize both service delivery and networking layers.

In optical, we are clearly the undisputed 800-gig leader, having been in the market for 18 months. We have secured the vast majority of opportunities globally and are now approaching 20,000 modems shipped. In the quarter, we added 11 customers for WaveLogic 5 Extreme, including Vaati (phon) and Windstream, bringing our total count to 106 customers. In addition, WaveLogic 5 Nano, our 400ZR product, is generally available and currently with several key customers as part of our certification and adoption process.

We are also excited about the opportunity next-generation metro and edge, where we expect to significantly expand our total addressable market from about 13 billion total currently to roughly 22 billion over the next several years. New use cases and technology disruption has created an important insertion point within this space for our architectural approach and we have all of the critical elements required to win, including IP routing, switching, optics, automation software and professional services. As many of you know, we've been laying the groundwork for expansion in this area for quite some time, including significant investment in both product development and our go-to-market resources.

As you probably saw this morning, we announced an agreement with AT&T to acquire its Vyatta virtual routing and switching technology. Vyatta's technology and software engineering team will bring additional resources to our routing and switching R&D team to address the growing market opportunity that we see with metro and edge use cases.

This includes continued development of our adaptive IP capabilities, and that in part increases our exposure to certain 5G use cases. We also, obviously, look forward to extending our strategic relationship with AT&T by directly supporting this key piece of their network in their transformation journey.

Overall, as customers seek out new architectural approaches and alternatives to the status quo, we've secured several significant architectural wins around the world for switching and routing. In fact, in Q3, we had 10 new wins for our routing and switching portfolio.

Finally, our Blue Planet software business continues to enjoy strong momentum, with our adaptive network vision that is well-aligned to network operators' automation priorities. With increasing customer engagements, we continue to win new significant deals, resulting in quarterly revenue growth of 47% year-over-year in Q3. We expect to deliver a strong Fiscal 2021, therefore, for Blue Planet, likely towards the high end of the $65 million to $75 million annual revenue range we previously provided.

Shifting to overall diversification in our business, across customers and regions, we had three 10% customers in Q3, including two Tier 1 service providers and a webscale customer. Highlighting our diversification, our top 10 customers in the quarter included four webscale companies, three North American service providers, one international service provider, one MSO and a wholesale company.

Non-telco revenue in the quarter was strong at 42%. Webscale revenue specifically grew 24% sequentially in Q3, with direct DCI business contributing 25% of total Q3 revenue.

Regionally, strength in EMEA continued, driven by webscale, growing more than 16% year-over-year. EMEA represents our fastest-growing region in the quarter and in fact, year-to-date as well. In India, we continue to navigate through COVID challenges and make progress, with revenue up 48% year-on-year and 26% year-to-date. I think, importantly, we are seeing investment by key customers for network upgrades in India, as well as replacement of Huawei equipment.

As I mentioned earlier, we are investing to capture ongoing secular demand for optical, routing and switching and network automation solutions, and to considerably expand our addressable market over time, really as the shift to the cloud continues, driving additional traffic growth and a greater need for network transformation. As a result, we are confident in our strong market position and in our ability to continue to outperform the industry.

With that, I'll turn over to Jim.

James Moylan, Jr.

Thank you, Gary. Good morning, everyone.

We generated strong Q3 revenue at $988 million. Adjusted gross margin in the quarter was once again very good, at 48.5%, reflecting a favorable customer and product mix, as well as a high concentration of capacity adds versus new builds. More specifically, we are not yet monetizing the new design wins to the extent we originally expected for this timeframe. Overall, we've been very pleased with the gross margins we have produced this year. They reflect the benefits of our scale and vertical integration, as well as a lot of hard work and lowering unit costs of both our products and our services.

Adjusted operating expense in the quarter was $290 million. With respect to profitability measures, we demonstrated extraordinary operating leverage in Q3, including adjusted operating margin of 19.1%, adjusted net income of $145 million and adjusted EPS of $0.92. In addition, in the quarter, cash from operations was $69 million, free cash flow was $54 million and Adjusted EBITDA was $214 million. We ended the quarter with approximately $1.5 billion in cash and investments. Also in Q3, we repurchased approximately 483,000 shares for $26.2 million.

Turning now to guidance; as Gary stated, the demand environment is very strong. This was reflected not just in our Q3 revenue that was well above the high end of our guidance, but also in our strong order flow in Q3 and an increased backlog. At the same time, global supply chain conditions have deteriorated, and we've always said that we would not be immune if those challenges persist, or especially if they worsen.

Taking these factors into consideration, we expect to deliver revenue in a range of $1.0 billion to $1.04 billion in Q4. At the midpoint of this guidance range, our revenue growth from the first half to the second half of Fiscal '21 would be approximately 26%. This would be a very strong second half performance, in line with the stronger than typical second half uptick that we forecast since the beginning of the year. Also, at the guide midpoint, we will deliver revenue growth for the year at just under 2%, above the midpoint of our revenue guide for the year.

For adjusted gross margin in Q4, we expect a range of 45% to 47%. This reflects our expectation for more monetization of new wins, as well as some impact of supply chain constraints. Finally, in Q4, we expect adjusted operating expense to be in the range of $295 million to $305 million, slightly higher than expected. Our order flow is well above our plan, as is our operating income, and this will result in higher variable compensation levels in Q4.

As always, we expect to provide detail about next Fiscal Year when we report our Q4 results in December. What I will say is that we are confident in a strong performance in Fiscal Year '22, even when factoring in supply constraints. As we have over a long period of time, we believe that we will outperform our competitors in both market share and financial results. Our technology leadership position, our expectations for a continued strong demand environment and a very solid backlog going into next year will enable us to continue the momentum we have developed.

Before we move to Q&A, I'm going to hand it back over to Gary for some closing remarks. Gary?

Gary Smith

Thanks, Jim.

I'd just like to give a brief update on a new ESG effort recently underway with our partner at Digital Promise. With the return to school in many parts of the world, we're excited to launch the Ciena Solutions Challenge, which invites middle and high school students around the world to design solutions that can address sustainable development goals within their local communities. This program, focused on computational thinking and digital skills, is one of several programs within our digital inclusion commitment.

To learn more about our programs like this and what Ciena is doing to help create a more sustainable and connected future, I'd encourage our shareholders and others interested to check our recently published Sustainability Report on our website.

With that, Operator, we'll now turn questions over to the sell-side analysts. Thank you.

Operator

Your first question comes from the line of Tal Liani with Bank of America.

Tal Liani

Hi, good morning. I want to ask about the verticals and if you can speak about—and you said there is strength in orders. Can you tie it with—what kind of projects do you see that are being forward now, what is the underlying service that carriers and clouds are offering that necessitate the investment platform now? Thanks.

Gary Smith

Thanks, Tal.

I would say that, from a vertical point of view, we've pretty much seen solid demand across pretty much most of the verticals. I would say it's a combination, a confluence on catch-up on capacity; the operation of caution that has been around for the last 12 months or so, so catching up on capacity. Also, modernization of the networks and architectures, particularly around the metro edge, facilitating 5G, etc., are also now ameliorating and people are investing and delivering operationally, coupled with, I think, the increase in demand as the adoption for the cloud has basically accelerated over the last 12 months.

You've got those three dynamics in play, and really, I'd say the overall application is to drive greater capacity at the edge of the network for all of the cloud applications that are well understood.

Tal Liani

Gary, can you talk about visibility? Earlier in the year, you had different kind of visibility; now you sound a lot better. Does this mean that you have greater visibility into next year?

Gary Smith

If you define visibility as order backlog, which is a key part of that, I think the answer to that is absolutely, yes. When we went into this year, there was a considerable amount of uncertainty. We saw a great deal of caution from the carriers, both operationally and fiscally. I think we have seen that ameliorate, as we thought it would, but as Jim said, that's resulted in a pretty significant uptick in our second half, 26% growth at the midpoint of our guide here.

I think that bodes well for '22. I think we're going to have a strong '22; obviously, it's a little early for us to talk about that, and we'll talk about that next quarter, but I think we've got better visibility now, absolutely, than we had when we started the year. I think the overall dynamics of demand, I think, are very, very positive going forward.

Tal Liani

Thank you.

Operator

Your next question comes from the line of Simon Leopold with Raymond James.

Simon Leopold

Thanks for taking the question.

I wanted to see if we could discuss a little bit about how you see your gross margin trending, and I'm not asking specifically about the October quarter. But when you consider your order trends—and what I'm struggling with here is, it sounds like you've got push-outs of the new footprint expansion which should be dilutive to gross margin, but I also suspect you've got a good order book on the routing and switching segment, which I imagine is accretive to gross margin. Help us understand the puts and takes, please?

James Moylan, Jr.

Sure. I'm going to take you back, Simon, to pre-COVID days, just to remind you of what we said. What we said then was we believed that our run rate for gross margin was in the mid-40s. That included a reasonable amount of new bills. We also said, as we started COVID, that for the next several quarters, we would enjoy a higher than mid-40s gross margin because we would not have the level of new bills in our revenue stack. That's exactly how this has played out. Actually, we're experiencing a good level of capacity adds, which are of course accretive. We've done pretty well on software, and we're doing pretty well on routing and switching. All of those things are impacting our gross margin as we have come through COVID.

I would not say anything differently about what I think our gross margin is going to be once we get to the expected levels of new fills (phon) in our revenue stack, which, it's going to happen. We see that, finally, in our order book. It's going to start hitting our revenue stack as we move into next year.

Now, we also have the supply chain which has impacted our fourth quarter, and in fact, our fourth quarter guide, which, we've gotten 47%, does have a fair amount of expected premium cost in getting material for hitting our expectations for revenue. That's what I'd say. I'd say, we're going to be, we think, 45% to 47% Q4. As we enter next year, it depends upon how much of the new wins are in our revenue stack and what the costs of the supply chain generate, but that's the expectation as we sit here today.

As I said though, we've been very pleased with our gross margin performance. We've done a lot of work to take costs out of both products and services. We have scaled. We have vertical integration. All of those things have helped us and we're very pleased with what we've done so far this year.

Simon Leopold

Thanks for that, Jim.

Just as a follow-up, I'd appreciate an update on the opportunity for Huawei swaps. I know you counsel the investment community to be patient, but I want to sort of reflect on what's different versus your prior earnings call, whether you've seen some evidence. You did mention some India traction, but appreciate an update on that Huawei opportunity. Thank you.

Gary Smith

Yes, Simon, I don't think anything has appreciably changed. As we've said, we've seen this dynamic for a while and it is clearly a multiyear tailwind. It's infrastructure; these things take time and those decisions take time. Then to execute on that, do the cap and grow or migrate traffic operationally, is very, very—it's a big undertaking by the carriers. But it's underway.

I would say, to your point about India, the one exception to that is, generally, the two areas here are Europe and India, with a few other countries in Asia. India, I would say, in the last six months, has accelerated that move, and they are actively replacing Huawei networks in India, and we've certainly been the beneficiary of that. We have good order flow and good new wins in India, some of which is on the back of that. Obviously, it'll take a little while to deploy over multiple years. But I would say, India acceleration, EMEA on track.

Simon Leopold

Thank you very much.

Gary Smith

Thanks, Simon.

Operator

Your next question comes from the line of George Notter with Jefferies LLC.

George Notter

Hi guys, thanks very much.

I want to revisit the gross margin discussion. You guys have printed significant upside relative to your guidance on gross margins for two quarters in a row now. I'm curious around why we've expected much more significant new build activity across these two quarters, and then actually not seeing that new build activity as the quarter has progressed. Why has that business shifted out so much?

James Moylan, Jr.

Well, as we come into any quarter, we have expectations of what our mix is going to be, and things move around. I certainly wouldn't read anything ominous in the fact that it's been a little slower to develop than we thought. COVID has had some effect.

I'd say that we have started to see, in our order book, the effect of some of these wins, and we're definitely going to see those things come into our revenue next year. I wouldn't read anything into it other than as the ebb and flow in our business. I think the good news is we're doing so well with our mature customers, and we have such a high preponderance of capacity adds.

Gary Smith

I'd just add to that, if I can. I do think, Jim, you talked about at the end there, I do think generally, capacity adds and catch-up has been prioritized over new business rollouts. Those rollouts are absolutely going to happen; in fact, we've won a number of new deals in the last quarter indicating the modernization of these networks. But I think carriers, and I'll be generalizing here, but I think have prioritized their capacity a little bit more than we thought, and that is resulting in better margins for us in Q3.

George Notter

Got it, okay. Then I also thought I'd just ask about the Vyatta transaction. I think that was an asset that came over from Brocade back in 2017 and we really haven't heard much about it within AT&T. Maybe you can talk about why you're buying that asset and what it really gives you going forward. Thanks a lot.

Scott McFeely

Yes, George, Scott here. The Vyatta assets, you're right in terms of the history. AT&T has used those to further their network transformation in a couple of different use cases around the edge, and virtualizing their capabilities around sell-side routers for the 4G and 5G backhaul and their enterprise business services for SMBs, so those use cases are very much in the sweet spot for what we're trying to accomplish in our next-generation metro and edge campaign.

If you look at the assets that we're picking up, it adds a capability set to enhance our routing and switching portfolio as we address the increased market size of next-generation metro and edge. It obviously deepens our relationship with a really important customer of ours, AT&T, and we pick up an engineering resource in a location that we had no presence before in the U.K. Those are the three dimensions of value for us.

George Notter

Is there a revenue run rate that comes with that product line?

Scott McFeely

There is; it's not material to our business, really, but there is a revenue run rate. We'll reflect that in our '22 plan when we get to that.

James Moylan, Jr.

Thanks, George.

George Notter

Thanks.

Operator

Your next question comes from the line of Rod Hall with Goldman Sachs.

Rod Hall

Hey guys, thanks for the question and good morning.

I guess I wanted to start off with the revenue guide, and Jim, maybe just ask you if you'd taken a shot at estimating how much impact to that guide there was from supplies, or if you can give us any color on how much of an impact on revenue the supply situation is in the guidance?

James Moylan, Jr.

Yes. I'll start by saying, remember, we outperformed in Q3 and when you take everything into account, we're probably low 10s of millions below what we could've done, were it not for the supply chain issues.

Rod Hall

That's in the guidance?

James Moylan, Jr.

Yes, it's in the guidance. For the full Fiscal Year, it's low 10s of millions.

Rod Hall

Oh, for the Fiscal Year, but also low 10s in the Fiscal Q4 guidance, is that the way we should think about it?

James Moylan, Jr.

Yes, I think you should, yes.

Rod Hall

Okay. Then, the other thing I wanted to just check, the gross margin guidance. I know you kept the high end of the range unchanged and you dropped the bottom. The 45% level, I was curious what that corresponds to? Is that if some of these expediting costs and so on go up or continue to go up, and 47% is assuming they hold where they are? Can you give us some color around either end of that margin guidance, what it takes to get to 47% and what happens if you end up printing 45%?

James Moylan, Jr.

There's always going to be variation in our gross margin, because as I said earlier, we start the quarter with an expectation of what's going to roll through, and things change. I think the difference between 45% and 47% is mostly going to be mix. Is the mix going to be different from what we expect? We've already set up our supply chain for the quarter, so I don't expect any more costs out of the buying of parts or anything like that. I'd say it's going to be mix that's going to drive the ends of the range.

Rod Hall

Is it fair to say that mix would be driven by these deployments, the big North American deployments in particular? What in the mix might change one way or the other in the forward quarter?

James Moylan, Jr.

It could be the deployment of the new wins, but remember, we have a lot of different customers, we have a number of different products; we have software mix, we have a lot of things that can impact our margin. Generally speaking, it's going to be the mix of all of those things, and 45% to 47% is where we think we'll come out.

Rod Hall

Okay, great, all right. Well, thanks a lot, I appreciate it.

James Moylan, Jr.

No problem.

Gary Smith

Thank you.

Operator

Your next question comes from the line of Meta Marshall with Morgan Stanley.

Eric

Hi team, this is Eric (phon) on for Meta, thanks for taking our question. Congrats on the quarter.

Maybe I just want to ask, given some of the order flow you were seeing and presumably, that being gated by supply chain converting into revenue, does that have any impact in some of the normal seasonality you would see into the first half? I understand it's early to comment on '22, but anything you can tell us there?

Gary Smith

I would say this, Eric. I think it's definitely too early to tell. We haven't finished this; we're just about finishing up this year. I do think that, as Scott said earlier, that the supply chain issue—our view is, will likely continue for the first part of the year, and obviously, when we do give FY'22 guidance as we come out of the year, we'll take that into account, as we have for the last couple of quarters here. I would say that I think we're very well-placed to navigate through it better than anybody else in our industry, but we're clearly not immune from that. But our scale and vertical integration and very sophisticated supply chain enables us to mitigate a lot of those customer delivery issues, but we aren't immune from it.

Eric

Got it, that's helpful, thank you.

If I could squeeze one more in on hyperscale, as you're seeing the strength there, and it looks like India continuing, is that just the continuation of some of the scaling build-outs, the hyperscalers you're doing in that region? You mentioned 800-gig products starting to test, but if you could update on maybe some of the expectations for timing and share as 800-gig starts to ramp even more?

Gary Smith

I'll take the first part of that and then maybe Scott can comment on the 800-gig adoption there. I think the engagement with those webscale folks is multifaceted. It's connecting their datacenters, both long haul, it's their global networks as well; we do a lot with them in different countries. We're the number one supplier to all of them on the submarine cable side, so we have a pretty intimate relationship with them across a very broad range of applications. I would say that they're continuing to roll out both additional datacenters and increasing connectivity within their existing datacenters, both within North America and internationally. We're seeing pretty healthy demand dynamics across the board on that.

Scott, do you want to talk about 800-gig?

Scott McFeely

Yes, and Eric, just one thing to add to what Gary said. The other part of the relationship with them is, they still do a lot of business in parts of the world, EMEA, Europe as well, through managed service providers. Our relationships with the service providers in those geos also benefits the relationship and we get benefit from that, so that's part of that EMEA growth as well.

Your 800-gig comment, Eric, I just want to clarify something that we said. Our 800-gig product is represented by our WaveLogic 5 Extreme product, and that's been in the marketplace now for almost a year and a half, approaching a year and a half. We're almost at 20,000 units shipped of that, so it's well beyond trials. It's mainstream deployment. What you might be referring to is our WaveLogic 5 Nano, and as Gary referred to in the script, as our 400-gig ZR product which just recently went generally available, and that's derivative of the same technology that's going through trials. Hopefully that clarifies it.

James Moylan, Jr.

Thank you.

Eric

Yes, thank you very much.

Gary Smith

Eric.

Operator

Your next question comes from the line of Paul Silverstein with Cowen & Company.

Mr. Silverstein, your line is open.

Paul Silverstein

Sorry, I need to learn how to use the mute button. Guys, relative to the light revenue guidance, first off, are you seeing any demand weakness or is that all a function of supply chain?

Second, Jim, if I recall, for a while, you've been talking about restraining Opex growth below single-digits, which, with any decent revenue growth, should result in some strong operating leverage. But after Opex declined for four straight quarters, you grew Opex by 15% year-over-year in Q3, over 15%, almost 8% in Q2. If I did the math right, the guidance works out to over 6% in Q3, the question being, has something changed in your Opex growth plans or do you still plan to go back to that low single-digit growth that you've been previously referencing and this is just a transitory issue?

Finally, are you seeing any impact, relative to street concerns about 400ZR in particular; are you seeing any impact from either of those? I know it's still early in 400ZR. Those are the questions.

Gary Smith

Okay, so let me get… Yes, the first of your three questions, I'll try and answer, Paul, and then maybe Jim, on Opex.

On the revenue guide, I wouldn't describe it as light. I would say 26% uptick in the second half is pretty solid, and it's also in the higher end. At the midpoint of that, it's in the high end of our original guide at the beginning of the year, where we had very little visibility, so it's largely playing out as we thought.

I would categorically say nothing to do with demand. We would be able to get greater revenues in Q4, probably by low 10s of millions, if we had unfettered access to everything we wanted that was normal from a supply chain, so read into that, $20 million or so. But if we also look, we overachieved by more than that in Q3. It's all about supply chain. I do think those challenges will continue for the first half of the year, but the demand dynamics are incredibly strong.

James Moylan, Jr.

On the Opex call, we've also said consistently that we are committed to growing our Opex at a lower rate than our revenue, and we've done that consistently over the past decade. The COVID years were a brief exception to this, because our revenue was affected by COVID and our plan for Opex, well, we continued to invest. But again, we've grown revenue faster than Opex for a long, long time and that would be our expectation going forward.

Now with respect to the specifics of Opex for this year, we're right on our plan overall. If you'll recall, we went through a whole recitation of how we expected our Opex to perform. At the beginning of the year, we said something like we thought we would average about $280 million a quarter. We were very low in Q1, and we said that we were going to be a little higher for the last three quarters, $285 million to, I guess it was $285 million for the last three quarters of the year.

Yes, we're a little higher than that this quarter; we are seeing a bit of FX with respect to the weaker dollar FX. For Q4, it's really all about the fact that we're so outperforming on orders, and our operating income, that our incentive compensation will have to reflect this over-performance in Q4. We are absolutely on-plan with respect to our Opex for this year.

Scott McFeely

Then on your last one, Paul, on the 400-gig ZR, the short answer is no. We're not seeing any impact on our business right now. I don't think our perspective of the opportunity set has changed. We sort of see the market being on total addressable market in the $500 million per year range as it gets up to full maturity. We think 2022 is the first year where you start to see some significant revenue opportunities there.

Our product addressing that is the WaveLogic 5 Nano that recently went GA (phon). We think it is the best-performing plug in the industry in terms of optical performance and power, so quite excited about its opportunity. I'll remind you, the folks that I think will be the first movers in this, a couple of the large webscalers. For that particular application, it is upside opportunity for us because we don't largely participate in those applications today.

James Moylan, Jr.

Thanks, Paul.

Next question please?

Operator

Your next question comes from the line of Alex Henderson with Needham.

Alex Henderson

…very much. Just a quick one to start with, just a data point. You gave up 24% quarter-to-quarter growth in the webscale. Can you say what that was on a year-over-year basis?

The question I wanted to address though is around the supply chain issues and the mix. Did the supply chain impact capacity adds differently than new footprint builds? Is there any variance in that as a result of the parts that you're able to get, or is that completely independent of the conditions?

Gary Smith

Alex, let me take the first part of that. I think I'm right in saying that if you looked at year-over-year, direct DCI, I think it's about 1% growth currently, as you close out of Q3. I think that might be greater as we look at Q4, but I think it's just over 1%.

Scott McFeely

On your second…

James Moylan, Jr.

You'll remember that the first part of this year, our revenue stream was very much impacted by COVID. All customers were down, or they were lower than what they would've been…

Scott McFeely

Including webscale, yes.

James Moylan, Jr.

…including webscale, so that 1% reflects that.

Scott McFeely

Alex, to your second question, the challenges and supply chain is the much-written about semiconductor challenges that is multi-industry really. That doesn't have a concentrated impact. It's actually pretty widespread across the whole portfolio, so I wouldn't draw any conclusion as to one part of the portfolio versus the other being more hit.

Alex Henderson

Yes, the follow-up I wanted to ask is on Vyatta. You said it wasn't material to revenues, but you're obviously bringing in assets, and to that extent, I would assume that you're bringing costs associated with it. I would also assume that that's predominantly in the R&D line. Is that an accurate calculus?

Scott McFeely

Yes.

Alex Henderson

If so, what's the scale of the costs that you're bringing in?

James Moylan, Jr.

Not a material number, Alex. We'll address all of that revenue, Opex, etc., once we get to close and when we talk about next year.

Alex Henderson

Okay.

Gary Smith

Just to confirm the opening part of question, yes, it is largely almost entirely in the R&D line.

Alex Henderson

Okay, great. Thank you very much for letting me ask the questions, thanks.

Gary Smith

Alex.

James Moylan, Jr.

Alex.

Operator

Your next question is from Samik Chatterjee with JPMorgan.

Samik Chatterjee

Hey, good morning. Thanks for taking my questions.

If I can just start with the strong backlog that you have, and I understand you're constrained on supply capacity a bit here, but investors that we speak to generally assume that, because of the constraints that you have and the strong backlog, it should lead into some pent-up demand for next year and help (inaudible) of a typical level of revenue growth. I know you don't have a guide for next year yet, but most investors seem to be benchmarking you to the 6% to 8% prior long-term growth guidance that you had.

I was just curious, how should we think about the (inaudible) backlog once supply constraints ease and leverage what investors think will be pent-up demand that is projected in your strong backlog delivery (phon)?

Gary Smith

Thanks, Samik.

I would say that, first of all, it is too early for us to talk about '22. We haven't even finished the year that we're in yet, and we never give guidance at this time for '22. We've said a couple of forward-looking comments around supply chain challenges continuing, so I would certainly consider that as we turn into the year. I think we've got this dynamic where you've got very strong secular demand, we've won a lot of new business, we're incredibly well-positioned; offset that against the supply chain challenges. I would also say that, the effects of COVID, basically, we've been running with lower backlogs than normal. To some extent, we've just replenished the coffers there.

I think we're in a much more normalized position going into '22. We absolutely think that you'll see decent market growth next year, and we will outperform the market. We will continue to take share, no doubt about that.

Samik Chatterjee

Okay, got it. If I can follow-up, I think, Jim, you mentioned that the new award push-outs, new award derivative deployments and push-outs relative to that is largely absent closing the business. Just curious, how is it different from what we saw last year or during COVID, just given some of the push-out that happened back then? What's giving you the visibility that it's not the similar situation as we saw last year?

James Moylan, Jr.

Well, I think, first of all, the new wins are showing up in our order book now. It's just a question of time before we get to revenue on them. That's the main thing, I would say.

I'd also say that, as we said earlier, COVID has certainly driven people to add capacity as opposed to new build-outs. That's caused the dynamic that we've seen, but it is coming, no doubt about it. The new business will show up in our revenue stack.

Gary Smith

Thank you. Thanks, Samik.

James Moylan, Jr.

Thank you.

Operator

Your next question is from the line of Fahad Najam with MKM Partners.

Fahad Najam

Good morning, thank you for taking my question.

I had a clarification, you have not only provided the breakdown of the three 10% customers, how much…

James Moylan, Jr.

Sorry, you wanted, three 10% customers?

Gary Smith

How much in total.

Fahad Najam

Yes, how much.

Gary Smith

How much in total?

Fahad Najam

(Cross-talking).

Gary Smith

Certainly over 30%. Hang on a second, we'll get that for you, Fahad.

James Moylan, Jr.

It's around 38%.

Gary Smith

Thirty-eight percent.

Fahad Najam

Okay. I want to follow-up on Samik's question. I think you've historically said that you think the industry is growing, low to mid-single digits. Do you still have that view?

Gary Smith

Yes, I think if you look at the last decade, pretty consistently, it's been in the mid-ish single-digit growth. We've been able to continue to outgrow that. I think all that was disrupted with COVID, like most industries, where we had, pretty much, I think, flat from an industry growth point of view.

I do think that we will return to, some point here, more normalized growth in the mid-single digits. I don't see any reason that that wouldn't be the case. Secular demand and getting higher bandwidth closer to the customer is absolutely everywhere about every application around the globe. Whatever you look at, be it 5G, be it fiber-to-the-home, FTTP, Internet of things. The secular demand, I think, is very positive. Yes, I would expect the industry to return to a more normalized pace. As I said, I think we will continue to grow faster than that.

Fahad Najam

Gary, if I can ask you to maybe double-click on that comment, because I want to tie this to one of your comments in the prepared remarks about the emergence of this new edge cloud opportunity I think is an entirely new build-out of network infrastructure. I just wanted to make sure that, if that significant TAM expansion that you are talking about correlates to the overall industry growth, or does that really take the industry growth to a next level because coherent optics is just getting pushed deeper and deeper into the network.

Gary Smith

Yes, Fahad, actually, that's a good question. When I answered your question, I'm generally talking about the optical system space. I think you are seeing, particularly as we're a challenger in this edge metro convergence, basically, so for us it's an expanded TAM. You've also got certain segments of that market that are growing faster than the mid-single digits as well. You've got some in the overall core routing that's actually going down; obviously, we're not targeting that. I don't think the world needs another core router vendor.

But in the convergence space, we have some unique assets that we think we can disrupt and challenge that market space over time. That will, I think, in the long-term, provide us a better growth opportunity than even the one we're seeing now.

James Moylan, Jr.

Thanks, Fahad.

Fahad Najam

Appreciate (audio interference).

Gary Smith

Thank you.

Operator

Your next question comes from the line of Jeff Kvaal with Wolfe Research.

Jeffrey Kvaal

Yes, thank you very much, also, struggling with the mute button a bit.

Two questions for you. First is, what can you tell us about your inventory balances? A lot of other folks in networking, although not necessarily in optical, have greatly expanded either inventory balances or their purchase commitments. I'm wondering what you're able to do there, what you might be able to get done in the future to help give us a little bit better visibility on your ability to reach the demand that you talked about?

Scott McFeely

Yes, so Jeff, for sure we are reaching out to our supply chain and making increased commitments, both in terms of volume, because we're growing the business, and duration. That is going to have an impact on inventory balance. You've seen some of that already and that's going to continue. You will see higher than what may have been our normalized inventory levels and lower turns as a result for the foreseeable future.

Jeffrey Kvaal

Okay. We can expect them to go up from where we are now, I guess, Scott…

Scott McFeely

Yes.

Jeffrey Kvaal

…(cross-talking)? Okay. Then secondly, it looks like the services business had a strong quarter. I'm wondering if you could deconstruct that a little bit and let us know how much of that is ongoing and how much of that was one-time?

Scott McFeely

Yes. If you think about our services business at a really level, think of it as three bins or the maintenance of the existing install base, the networks and the customer relationships, that's a pretty steady state, if you like, and predictable. The second piece of it is around the installation projects as very tied to our new projects and business wins, so that will ebb and flow with the projects. The third piece of it, which we're quite excited about, is a set of professional services around helping our customer transform their networks from legacy networks into next-gen. That's actually had quite a good run; it's still relatively—the smaller of the three of those pieces, but that's actually contributed to the good services mix that you saw in the quarter.

Jeffrey Kvaal

How sustainable is that, Scott? Should services go back to its more normal run rate in future quarters?

Scott McFeely

We think that that third bin, that professional services mix and helping our customers migrate their networks, is going to be an opportunity for us going forward in the future, and we think that we have an opportunity to grow that.

Jeffrey Kvaal

Thank you.

James Moylan, Jr.

Thanks, Jeff.

Operator

Your next question comes from the line of Amit Daryanani with Evercore ISI.

Amit Daryanani

Good morning, everyone. Thanks for taking my questions.

I have a few as well. First off, maybe I missed this, but could you talk about the gross margin impact on supply chain headwinds in October quarter, sort of how you're thinking of that? Then, probably due to these supply chain headwinds, peak in October quarter, or do you think they continue to get worse in the period as we move through the first half of your Fiscal Year?

James Moylan, Jr.

We didn't talk about an effect in Q3. There was very little effect of the supply chain situation in Q3. Q4 is going to impact us. Now, with respect to next year, we do know that the supply chain is going to continue in that constrained state, but how much and how that's going to affect gross margin, it's really too early to say.

Amit Daryanani

All right. Then, your Blue Planet growth, I think a few quarters in a row, it seems to have inflected much higher, 45% (inaudible) on a growth vector. Can you just touch on, were there a couple of big projects that were ramping up and that's what drove it, or just what drove that growth and the durability of Blue Planet growth as you go forward would be helpful to understand.

Gary Smith

Yes. I'd say first off, in full disclosure, it's from a relatively small base, so those numbers look spectacular, but they're from a small base. I would say that what we are seeing now is adoption by significant Tier 1s around the digitization of their service layer, basically, replacing the old legacy back office systems. We are seeing that move forward in a step function this year. It's not necessarily showing up in all of the numbers; we're seeing very good numbers, both on orders and revenue, relative to the plan. I think we'll probably be over on both, in the high end of our guide on revenue.

But perhaps even more importantly with that, we're getting significant footprints in potentially multiyear rollouts of the digitization on the service layer, and things like inventory management, service provisioning, etc. It's very encouraging with Blue Planet. We'll talk a little bit more about that, I'm sure, as we talk about '22 and beyond, as we talk about that at the end of this year, but very encouraged by what we're seeing.

James Moylan, Jr.

Thanks, Amit.

Operator

Your next question comes from the line of Tim Long with Barclays.

Timothy Long

Thank you.

Two if I could as well; Gary, just wanted to go back to the metro edge TAM and the challenger piece there. Could you maybe just click down, give us a little more info on how timing to attack that extra TAM and how are you going to get there? Is it adding the Vyatta assets, is that a part of it? Is it leveraging install base? Because it's an area that obviously could be a big growth vector for you guys.

Then, second, if you can just touch on a few point markets; India, given the macro issues there, as well as submarine? Thank you.

Gary Smith

Yes, let me just talk—on the metro edge, obviously this has been a journey we've been on for a while. We've been investing in key strategic assets in the packet space, in routing, switching, in the software, the convergence with optical. Our architectural vision with the adaptive IP is a much simpler, highly automated architecture, and we are the challenger in that space. We are securing wins with that, as you've seen over the last 18 months or so, and I think that's gathering momentum. We're excited by what we're seeing; still early days. I think this is a two to five-year expansion of our opportunity.

Whilst it's a big market, we're challenging there some very strong incumbents, but I think we're proving we've got a very compelling differentiated value proposition with the assets that we've got. I think that will be an important market for us, and it's a key investment. We're scaling investments, both at the front end of our business in our go-to-market capabilities and support, and also, as Scott talked about, in our engineering capabilities, and Vyatta is another key add to that. We're bringing some really tremendous specialist talent into the Company.

What was the second question?

James Moylan, Jr.

It's India…

Gary Smith

India.

James Moylan, Jr.

…and submarine. We said earlier that India is a place which has moved very aggressively to exclude Huawei from new builds. There are opportunities for us; we have taken advantage of those opportunities. We have several new wins. We expected this year that those would—that India would start to show in our revenue stack a little higher, and that has been the case. It's not quite 5% of our revenue, but it's up very nicely. Year-to-date, it's up 26%. Quarter-over-quarter, it's up a lot more than that, but I think the year-to-date number is much more meaningful, up 26%. It's going to be a great place for us to be for a long time.

On the submarine, submarine is up a lot this year or at least in the quarter. It's up 27% in the quarter; it's about flat year-to-date. We've done extremely well in the submarine market. It plays to our strengths. The submarine market requires long reach at high capacity, and we're the best in the world at it. I think we'll continue to win there.

Timothy Long

Thank you.

Gary Smith

Thanks, Tim.

James Moylan, Jr.

We'll take one more question.

Operator

Your last question comes from the line of Jim Suva with Citi.

James Suva

Thank you.

When we think about the supply chain issues, have you materially changed your pricing for things also, about shipping, and have a fully folded into your gross margins, or are they still being calibrated?

Then on your bookings and orders, is there any concern about customers double ordering or ordering ahead knowing that they have supply chain issues, or in the optical components, is it just not as much of a concern as maybe other sectors that we see where there's double ordering? Thank you.

Scott McFeely

Jim, if your first question was around our costs…

James Suva

Correct.

Scott McFeely

…we're certainly see costs of both procuring components and the logistics costs having an impact on the margin. That's fully baked into our gross margin guidance for Q4.

On your second question…

Gary Smith

Your second question, was that about orders on us or orders that we're placing on our supply chain?

James Suva

Orders around both sides coming in as customers—is there a chance that they're double ordering, and are you guys seeing the shortages? Does it make sense to order a little more to have some buffer as we progress in the quarters ahead?

Gary Smith

I think given the nature of the industry, it's extremely unlikely. The intimacy we have with these customers on the system side, I think that's zero risk, frankly, on that side. On the supply chain side, I think the relationships that we have, again, on the supply side there is very intimate and longstanding.

James Moylan, Jr.

Thank you, Jim.

James Suva

Great. Thank you so much.

Gary Smith

Thanks, Jim.

James Moylan, Jr.

Thanks, everyone, for joining us today, we appreciate it.

We're looking forward to catching up with folks today and over the next several days. We've got a number of conferences we're attending. Thanks and stay safe.

Operator

Thank you. This concludes today's conference. You may now disconnect.